

Unrelated income; rental of dormitory facilities. The rental of dormitory rooms and similar residential accommodations, primarily to people under age 25, by an exempt organization whose purpose is to provide for the welfare of young people is substantially related to the purpose constituting the basis for the organization's exemption and does not constitute an unrelated trade or business within the meaning of section 513 of the Code.

Advice has been requested whether, under the circumstances described below, the rental of dormitory facilities by an organization exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code of 1954 constitutes unrelated trade or business within the meaning of section 513 of the Code.

The declared purpose of the organization and basis for its exemption under section 501(c)(3) of the Code as a charitable organization is to provide for the welfare of young people by the conduct of charitable activities, and maintenance of services and facilities that will contribute to their physical, social, mental, and spiritual health, at a minimum cost to them, or where appropriate at no cost to them, by various desirable means. As one of its programs, the organization makes available facilities of study, recreation, and abode of homelike character, and a wholesome, decent environment and guidance designed to foster good citizenship and high ideals and character.

The organization rents dormitory rooms and similar residential accommodations primarily to young people under 25 years of age. Some rooms are rented, however, to low income persons who are over 25 years of age at a minimum cost to them. There are various types of accommodations ranging from single occupancy rooms with bath through multiple-occupancy rooms for which separate bath facilities that serve several such room units are available, to large halls suitable for rental to groups such as scout groups, for example, who sleep in sleeping bags on the floor.

The residence units are operated on and as a part of the same premises in which the organization carries on its social, recreational, and guidance programs. Membership in the organization, for which a nominal fee is charged, is required of those seeking room accommodations.

An applicant for residence signs a statement that he is in sympathy with the purposes of the organization and will abide by the rules and regulations which prohibit loitering, gambling, and use of alcoholic beverages. The dormitory facilities are under the management and supervision of career professionals who are trained to provide personal guidance and counseling. The residents are provided with personal counseling, physical education programs, and group recreational activities.

Section 513 of the Code defines the term 'unrelated trade or business' as any trade or business, the conduct of which is not substantially related (aside from the need of an organization for income or funds or the use it makes of the profits derived) to the exercise or performance by an organization of its exempt purposes or functions.

Section 1.513-1(d)(2) of the Income Tax Regulations provides that a trade or business is 'substantially related' only if the production or distribution of the goods or the performance of the services from which the gross income is derived contributes importantly to the accomplishment of the purposes for which exemption was granted.

Providing living accommodations with a wholesome and decent environment to young persons contributes importantly to the organization's purpose of providing for the welfare of young people. In addition, by making its rental facilities available at minimum cost to low income persons, regardless of their age, the organization is assisting a recognized charitable class in a manner compatible with its exempt purpose.

Accordingly, the residency program is substantially related to the purpose constituting the basis for the organization's exemption and does not constitute unrelated trade or business within the meaning of section 513 of the Code.